

**NATIONAL COUNCIL OF STATE HOUSING AGENCIES
RECOMMENDED PRACTICES IN COMPLIANCE MONITORING**

**Consistency Among State Housing Credit Allocating Agencies:
Recommended Practices in Compliance Monitoring, Capital Needs
Assessments, Operating Cost Databases, and Accountant Opinion Letters**

Background

Congress has delegated responsibility for administering the Housing Credit to the states, recognizing that each state is better able than the federal government to address the low income housing needs unique to its citizens. Within the statutory and regulatory parameters set forth by the Congress and the Internal Revenue Service, the states have developed a variety of practices for allocating Housing Credits and monitoring the resulting developments for compliance.

Since 1992, the states, through NCSHA, have developed numerous "Recommended Practices" to strengthen state administration of the Credit. The Congress and the U.S. General Accounting Office have cited these Recommended Practices and their implementation by most states as proactive measures that enhance state administration of the program.

Consistency in some procedures and reporting among the states strengthens the Housing Credit program by streamlining and simplifying agency reviews and creating efficiency and clarity for developers and other Housing Credit industry professionals. In other areas, uniformity among the states is impractical or inconsistent with states' need for flexibility to respond to their unique priorities.

In October 1998, NCSHA's Board of Directors adopted the report of its Housing Credit Task Force, which recommended practices in Housing Credit allocation and underwriting. That report also recommended that NCSHA: (i) consider existing state allocation and compliance practices to determine where standardization would best streamline Credit administration; (ii) define components of a capital needs assessment; (iii) suggest components of an operating cost database; and (iv) develop further recommended practices in Housing Credit compliance.

NCSHA President Bob Kucab instructed the NCSHA staff, through consultation with HFA Housing Credit staff and industry experts, to produce recommended practices on these subjects for the Board's consideration. The process for achieving those recommended practices and the practices themselves are the subject of this report.

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Part One: Recommended Practices in Housing Credit Compliance Monitoring

Congress in 1992 required states to monitor Housing Credit properties for program compliance, subject to IRS guidelines issued later that year. Since then, states have developed sophisticated and efficient monitoring systems that go well beyond the minimum requirements imposed by the Service's regulations. Tailored to respond to specific state needs, compliance practices vary considerably from state to state.

The process for developing recommended compliance practices was designed to include all state allocating agencies from the outset and to seek the views and comments of agency executive directors, Housing Credit staff, and private sector experts at multiple stages of the product's development. We began by developing an outline of issues for a roundtable discussion with state Housing Credit compliance staff at NCSHA's 1999 Housing Credit conference. That discussion and subsequent ones with state compliance staff and industry experts identified those issues recommended practices should address.

NCSHA then convened a series of conference calls with HFA compliance staff to discuss standardized compliance reports, forms, and certifications. During these calls, the group developed six standardized documents, including a tenant income certification, owner's certification of continuing program compliance, employment verification form, certification of zero income, under \$5,000 asset certification, and student verification.

All states discussed potential recommended practices and reviewed the six standardized documents at NCSHA's January 2000 Housing Credit workshop in Washington. Several Housing Credit industry compliance experts also participated in these discussions.

With significant input from agency compliance staff, NCSHA drafted the recommended practices in this report and circulated them to every state Housing Credit agency for comment. Revised recommendations incorporating staff comments were then sent to HFA executive directors and private sector experts for comment.

We received comments from several national compliance trainers, the National Association of Home Builders' Housing Credit Group, the Affordable Housing Investors Council, and others. All of the industry representatives praised the initiative and provided constructive comments on the recommendations. Some industry comments were conflicting, and some suggested that additional discussions with the industry, particularly on the standardized documents, were necessary to produce optimal recommendations.

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Those discussions were held at NCSHA's 2000 Housing Credit conference in San Diego, where Housing Credit staff and industry representatives discussed another draft of the report. A subsequent draft, incorporating state and industry comments from San Diego, was circulated to all state executive directors, their Credit staff, and industry representatives for comment in July. The results are reflected in this final report. These recommended practices represent the minimum standards that all states should meet in monitoring Housing Credit properties for compliance, regardless of other differences among them.

Compliance Manuals

Recommendation: Agencies should make available a Housing Credit compliance manual, with all necessary regulations and forms, as a comprehensive resource for owners and managers. Agency monitoring staff should use such manuals to ensure consistency in monitoring developments within the state. Staff should review and update compliance manuals periodically.

Discussion: Agencies recognize that compliance requirements are extensive and complex. Manuals informing Housing Credit property owners and managers of what they must do to keep properties in compliance have proven to be invaluable tools in many states. These manuals differ in scope but frequently describe owner and management responsibilities, IRS regulations and forms, and state documents relating to compliance.

Owner/Manager Training

Recommendation: Agencies should strongly encourage owners and on-site managers of Housing Credit developments to attend or document that they have recently attended training on management and compliance prior to property lease-up, but no later than receipt of IRS Form 8609, which certifies an allocation of Credits. Agencies should also strongly encourage such training following significant or repeated noncompliance events. At a minimum, such training should cover key compliance terms, qualified basis rules, determination of rents, tenant eligibility, file documentation, next available unit procedures and unit vacancy rules, agency reporting requirements, record retention requirements, and site visits.

Discussion: Successful operation of a Housing Credit development is management intensive. Thorough understanding of Housing Credit development requirements and compliance monitoring procedures requires training of development owners and managers. This training should be provided to the property's on-site management staff before the property is occupied.

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Coordination of Monitoring Activities

Recommendation: To the extent practical, agencies should coordinate compliance reviews for Housing Credit developments financed with multiple subsidies.

Discussion: Developments with multiple subsidies (i.e., Housing Credit and HOME) are subject to reviews for different program compliance requirements. Furthermore, the division within the agency responsible for monitoring one program may not be the same division, or even the same agency, responsible for another program. This situation is inefficient, as each responsible party collects duplicative information. It is also a burden on property managers and the low income tenants who must accommodate multiple property reviews.

Transmittal of Development Information

Recommendation: Agencies should develop procedures for transmitting critical development information from allocation to monitoring staff. At a minimum, this information should include the completed IRS Form 8609 for the development, once obtained from the owner, and any extended low income housing commitments that document tenant income or other property restrictions.

Discussion: Different agencies or divisions within an agency often carry out Housing Credit allocation and monitoring. Coordination and communication between them is critical to compliance staff having the development information necessary to effectively monitor. Development information included on IRS Form 8609, such as the owner's certification of the original qualified basis of the building at the close of the first year of the Credit period and the election to begin the Credit period of a building the first year after it is placed in service, is essential information for property monitoring. Extended low income housing commitments, documenting income set-asides and other property restrictions, are also critical. Monitoring staff also needs the qualified allocation plan in effect at the time of the allocation and any additional loan agreements, especially if the Credits were allocated by a different agency.

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Distributing Income and Rent Limits

Recommendation: Agencies should make updated Housing Credit income and rent limits available to development sponsors and managers annually.

Discussion: HUD issues revised income limits each year that must be used to qualify tenants and determine new rent limits in Housing Credit developments. Some development sponsors and managers apparently are unaware that the income and rent limits change each year and rely on incorrect limits for income qualification.

Monitoring Fees

Recommendation: Agencies should develop a reasonable monitoring fee structure taking into account the cost of monitoring to the agency and the impact on developments. Given that fees may change over time, agencies should notify the development community of any such changes in the qualified allocation plan or through other state notice.

Discussion: Monitoring Housing Credit developments for the mandated compliance period is costly, and new requirements imposed by the IRS in its recent compliance regulations may make it more costly. It is reasonable for agencies to pass this cost on to development owners in the form of compliance monitoring fees. The IRS clarified in its monitoring regulations that federal law does not prohibit an agency from charging fees to cover the agency's monitoring expenses.

Monitoring Section 515 Developments

Recommendation: Agencies should execute a compliance Memorandum of Understanding (MOU) with their Rural Housing Service (RHS) field office.

Discussion: IRS compliance regulations allow agencies to exempt owners of Section 515 developments from the submission of tenant income certifications, supporting documentation, and rent records if the agency enters into an agreement with RHS to provide this information. RHS developed a model MOU for this purpose in 1993, which has been implemented by most states. IRS compliance regulations also permit exemption of Section 515 properties from habitability inspections beginning in 2001, provided that RHS inspects the property and transmits inspection results to the state agency pursuant to an executed MOU.

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Tenant File Review Procedures

Recommendation: When conducting tenant file reviews of Housing Credit properties, agencies should review the current rent record and, at minimum, verify the following from the tenant files for at least 20 percent of the development's low income apartments:

- Rental application completed, including certification of assets and disposal of assets, if applicable;
- Tenant income certification completed for move-in and current year, including all required signatures and dates;
- Income verification(s) completed and documented;
- Assets documented, and verified if total assets are more than \$5,000 in value;
- Student eligibility documented;
- Lease and lease addendum completed at move-in; and
- Current year utility allowance on file.

Discussion: IRS Housing Credit compliance regulations require state agencies to review tenant files of Credit properties on a regular basis but do not specify what must be evaluated in these file reviews. State agencies, based on their significant experience in conducting tenant file reviews, find the above essential elements of a thorough file review.

Calculating Anticipated Tenant Income

Recommendation: Agencies should instruct property managers qualifying tenants for Housing Credit apartments to calculate household income using the gross income the household anticipates it will receive in the 12-month period following the effective date of the income certification or recertification. For purposes of this recommendation, anticipated income should be documented in the tenant file by third party verification whenever possible or by an acceptable alternate method of verification with documentation as to why third party verification was not possible. States and property managers should use current circumstances to project income, unless verification forms or other verifiable documentation indicate that an imminent change will occur. Agencies should refer managers to HUD Handbook 4350.3 for guidance on the proper calculation of income and assets.

Discussion: For purposes of calculating annual household income, IRS regulations refer to HUD Handbook 4350.3. This handbook defines annual income as the gross income the household anticipates it will receive from all

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sources, including all net income derived from assets, during the 12-month period following the effective date of the income certification or recertification. Third party verification of annual income and the value of assets is the preferred method of verification for HUD programs. Alternate methods, such as pay stubs or income tax returns, are allowed in the event third party verification cannot be obtained and the file is documented accordingly.

Student Households

Recommendation: For purposes of qualifying student households to live in Housing Credit developments, agencies should in general:

- consider a single person household ineligible if he or she is a full-time student at the time of initial occupancy or will be at any time during the certification period (unless the individual meets one of the student exceptions described below);
- consider a household of students eligible if it includes at least one part-time student or meets one of the student exceptions described below;
- consider a household containing full-time students and at least one child (who is not a full-time student) an eligible household;
- not consider children enrolled in kindergarten through 12th grade to be full-time students; and
- consider TANF an acceptable Title IV program exception.

In addition, agencies should encourage Housing Credit property managers to utilize a lease provision in all Housing Credit properties requiring tenants to notify management of any change in student status.

Discussion: A household comprised entirely of full-time students may not be counted as a qualified household under the Housing Credit program, unless the household meets one of the following four exceptions:

- all household members are full-time students, and such students are married and file a joint tax return;
- the household consists of single parents and their children, and such parents and children are not dependents of another individual;
- at least one member of the household receives assistance under Title IV of the Social Security Act (i.e., AFDC assistance); or
- at least one member of the household is enrolled in a job training program receiving assistance under the Job Training Partnership Act or similar federal, state, or local laws.

IRS has not issued adequate guidance to states regarding qualification of

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student households, and as a result, state policies vary considerably. In a draft of its forthcoming guide on Correction of Noncompliance, IRS has attempted to address this situation with guidance consistent with this recommended practice. NCSHA and the states will continue to request clarification from the Service on student issues. Until IRS issues such guidance, the above recommendations will help to provide consistency on student eligibility among states.

Unborn Children

Recommendation: Agencies should count unborn children in determining household size and applicable income limits. If permitted by state law, agencies should require documentation of pregnancy in such circumstances.

Discussion: In qualifying households for Housing Credit apartments, property managers must know the size of the household to calculate the applicable income limit. State policies currently differ regarding the inclusion of unborn children in household size. To provide consistency with the HUD handbook requirement to estimate household income for a future 12-month period, household size should be measured over the same 12-month period and include any unborn children. Some property managers require documentation of pregnancy, such as a doctor's statement, in such circumstances.

Interim Recertifications

Recommendation: Agencies should require tenant income recertifications on an annual basis.

Discussion: IRS rules require Housing Credit property owners to recertify tenant income eligibility at least annually. Some property managers require interim recertifications for circumstances such as addition of a new household member or transfer of a household within the same building. IRS does not require interim recertifications. Agencies requiring them only on an annual basis will simplify the recertification process and reduce the paperwork burden on managers.

Encouraging Fair Housing Compliance

Recommendation: In addition to the IRS annual owner certification requirement for development owners to certify to the state agency any finding of discrimination under the Fair Housing Act, agencies should refer any fair housing

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complainants to the appropriate state fair housing enforcement agency.

Discussion: Beginning in January 2001, Housing Credit property owners are required to certify annually to the state monitoring agency any finding of discrimination under the Fair Housing Act. Because most state Credit agencies are not the designated fair housing agency for their state, they should develop a procedure for referring any fair housing complainants to the appropriate agency within the state and report any discrimination findings to the IRS as required by IRS Form 8823

Monitoring Property Restrictions

Recommendation: Agencies should require that extended low income housing commitments identify all requirements imposed on the development which are material to the award of Credit, including, for example, income restrictions, rent skewing, affordability period, reserve levels, amenities and services, definition of housing type, and requisite tenant qualifications. Compliance staff should monitor to ensure these commitments are met and report any noncompliance to the Service on IRS Form 8823.

Discussion: In making Credit allocation determinations, agencies frequently award additional points to developments that elect restrictions beyond those required by federal law, such as deeper income targeting, longer affordability periods, or special needs tenancies. Agencies can monitor and enforce these restrictions by incorporating them into extended low income housing commitments.

Standardized Forms and Reporting

Recommendation: Agencies should adopt the six attached standardized documents for use in Housing Credit monitoring.

Discussion: All states require Housing Credit development owners to use certain forms for compliance reporting. These forms differ from state to state. Standardization of some compliance forms among the states would create efficiency for developers and other Housing Credit industry professionals.